



Pensions Committee

2.00pm, Wednesday, 23 June 2021

Annual Investment Update – Scottish Homes Pension Fund

1. Recommendations

The Pensions Committee (Committee) is requested to:

- 1.1 note the asset allocation, investment performance and funding update of the Scottish Homes Pension Fund.

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Annual Investment Update – Scottish Homes Pension Fund

2. Executive Summary

- 2.1 This report provides an update for the year to end March 2021 on the strategic allocation and the invested assets of the Scottish Homes Pension Fund (the Fund).
- 2.2 As reported at the March 2021 Pensions Committee meeting, the funding level of the Scottish Homes Pension Fund at 31 March 2020 was 117.7%, an increase from 104.7% at the 2017 valuation.
- 2.3 In line with the Scottish Government’s guidance, the Fund’s objective is to minimise the investment shortfall risk of assets relative to liabilities. Accordingly, the Fund’s assets comprise UK gilts and cash as closely matched to the estimated liability payments as possible.

3. Background

- 3.1 The City of Edinburgh Council took over the administration of the deferred and pensioner liabilities of Scottish Homes (Fund) in July 2005. An agreement between the Scottish Government and the City of Edinburgh Council (the Guarantee) was put in place in June 2005 whereby the Scottish Government acts as the ‘Guarantor’ for the Fund liabilities.
- 3.2 The Guarantee and the investment strategy are designed to reduce investment risk as the Fund is closed to new members and the liabilities are maturing over time.
- 3.3 The Target Funding Level (TFL), as set out in the Guarantee, was 94.5% at 31 March 2020, the date of the last formal actuarial valuation, with a target of being 100% in 2044. The Actual Funding Level (AFL) at 31 March 2020 was 117.7%.
- 3.4 As the AFL was above the TFL, no deficit contributions are required from the Scottish Government (as Guarantor) for the period April 2021 to March 2024. The Guarantor is, however, responsible for meeting the cost of administration and oversight and governance. Investment expenses will be met from the current funding surplus.

4. Main Report

Funding Level

- 4.1 As reported at the March 2021 Pensions Committee meeting, the funding level of the Scottish Homes Pension Fund at end March 2020 was 117.7%, an increase from 104.7% at the 2017 valuation. The increase in funding level reflects actuarial revisions to financial and demographic assumptions based on actual experience over the three years as well as changes to asset values, which are not a perfect match for liability values.
- 4.2 As full funding had been achieved faster than expected, the Scottish Government was consulted over future funding options. It decided not to change the Funding Agreement, and so the investment strategy to minimise investment risk is retained.

Investment Objective

- 4.3 Given achievement of full funding, the Committee approved the following investment objective in June 2018:

To match the cash flow from gilt income and redemption payments as closely as possible with the expected liability payments of the Fund.

There is no change to that objective.

Investment Strategy

- 4.4 The strategic allocation to bonds (UK gilts) is essentially 100%. The actual allocation is shown in the table below.

Asset Class	Actual Allocation	
	31 March 2020	31 March 2021
Gilts	99.2%	90.5%
<i>Index-Linked Gilts</i>	63.6%	60.1%
<i>Nominal Gilts</i>	35.6%	30.4%
Cash	0.8%	9.5%
TOTAL	100%	100%
Asset Value (£)	£163m	£156m

- 4.5 A detailed analysis of the Fund's liabilities was undertaken during 2018/19 to ensure that the invested assets were as closely matched with the liability profile as possible, taking into consideration the expected duration of liabilities and whether they are fixed or index-linked in nature. This resulted in an increase in holdings of nominal gilts and a decrease in index-linked gilts to achieve a closer asset-liability match.
- 4.6 At end March 2021, the fund's assets are matched with the duration of the liabilities. The fund's strategy is to match the cash flows of liabilities one year

beyond the date of the next valuation and to match the duration of liabilities beyond that. This is because of the greater visibility of pension payments in the near term. Over the longer term, funding levels are subject to the actuary's financial and demographic assumptions of future experience, which are re-examined every three years. Some rebalancing of the fund's assets will be undertaken early in the new financial year to ensure that liabilities are cash flow matched until 2024.

- 4.7 At end March 2021, the funding level is estimated to be broadly similar to the position at the end March 2020 valuation.
- 4.8 As the Fund is mature, it must redeem maturing assets to pay pensions. Cash or cash equivalents are held to enable pensions to be paid in between the dates that gilts redeem. Over 2020/21, £7.2m was redeemed to pay pensions, which compares with the Fund value of £156m at the end of March 2021.
- 4.9 Being fully funded, the fund invests excess cash in short-dated bills and gilts. To avoid paying interest or taking undue interest rate risk on negative yielding assets, the fund increased the proportion of cash over the year. The cash balance at end March 2021 was equivalent to approximately two year's pension payments.

Transfer of employer - Homeless Action Scotland

- 4.10 The transfer of the assets and liabilities relating to former Lothian Pension Fund employer Homeless Action Scotland ("HAS") took place on 4 June 2020. At Scottish Ministers' direction, Scottish Homes Pension Fund was substituted as the appropriate fund for HAS. The actuary calculated the remaining liabilities that remained on cessation at £641,000.

5. Financial impact

- 5.1 The financial impact for the Scottish Government is described in paragraph 3.4. The funding level of the Scottish Homes Pension Fund, which depends on relative changes to asset and liability values, affects the contributions required from the Scottish Government. Lothian Pension Fund recovers expenses for administering and managing the Fund.
- 5.2 The Scottish Government's decision not to change the funding agreement provides greater certainty of the funding level, but at a potentially higher long-term cost.

6. Stakeholder/Regulatory Impact

- 6.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the fund and they are invited to comment on the relevant matters at Committee meetings.
- 6.2 There are no adverse governance, compliance or regulatory implications as a result of this report.

7. Background reading/external references

- 7.1 None.

8. Appendices

None.